FOUR YEARS MORE OF DEPOSIT GUARANTY

SUMMARY

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IF the reader has visited Texas, Oklahoma, Kansas, or Nebraska within the past few years he has probably noticed on the windows of some of the banks the sign

" Deposits Guaranteed." If he has gone inside he has found the same advertisement on the stationery. Bank deposits in these states are protected by funds raised by special taxation of the banks and administered by the state banking boards. The system, established in Oklahoma as an outgrowth of the panic of 1907, and followed with variations in the three other states mentioned, has for its objects the distribution among bank stockholders generally, of losses that have heretofore fallen upon the depositors of failed banks, and as consequences, the prevention of individual distress, the prevention of panics by maintaining the confidence of depositors, and the increase, due to such confidence, of the volume of deposits and the usefulness of banks. This experiment, unparalleled, except for the New York episode of three-fourths of a century ago, was discussed by the present writer in these columns four years since.[1] The progress of the experiment since that time now warrants further conclusions, and it is proposed now to review the incidents of the intervening period.

At the time of the former study, the question of the validity of the Oklahoma, Kansas, and Nebraska deposit guaranty laws was pending in the Supreme Court of the United States. The Texas law had not been attacked, its opponents being willing, apparently, to abide by the results of litigation over the laws of the other commonwealths.

The three laws attacked were all upheld on the principle that such taxation was not the taking of private property for a private purpose, but was the taking of private property for a public purpose, and a valid exercise of the police power of the states. It was held that the state undoubtedly had the authority to lay

[1] Quarterly Journal of Economics, vol. xxiv, pp. 85, 327; reprinted in Sen. Doc., No. 659, 61st Cong., 3d Session, Appendix B.

down such conditions precedent to the conduct of the banking business. " In short," said the court, " when the Oklahoma legislature declares that free banking is a public danger, and that incorporation, inspection, and the above described co-operation [the provision of a guaranty fund by taxation] are necessary safe-guards, this court certainly cannot say that it is wrong." [1]

This litigation had been conducted with bitterness on both sides and its termination was a relief. While the legal problems were much the same in the various states, the financial and administrative questions have differed, and the experiences of the various states require separate consideration.

I. Oklahoma

The first results of the guaranty legislation in Oklahoma had some appearance of success. The state banks gained rapidly in number and in business, while many national banks surrendered their charters and reorganized under the state law, the business of the remaining national banks keeping barely steady. For more than three years now the current has been the other way and the Oklahoma experiment is found to have cost the solvent state banks in five years more than two million dollars. Bank after bank has failed. Banks in large numbers have left the state system to enter the national system for the purpose of escaping the heavy assessments levied under the state law. The remaining state banks have now forced through a new law limiting more closely the annual assessments for the guaranty fund, and have been compelled to take

[1] Noble State Bank v. Haskell, 219 U. S., 104, 31 Supreme Court Reporter, 186; Shallenberger v. First State Bank, 219 U. S. 114, 31 Supreme Court Reporter, 189; Assaria State Bank v. Dolley, 219 U. S. 121, 31 Supreme Court Reporter, 189; Abilene National Bank v. Dolley, 33 Supreme Court Reporter No. 10, p. 409.

matters, as far as possible, into their own hands. Such a result was forecasted in the articles in this Journal three and four years ago.

The Oklahoma laws of 1907 and 1909 provided for the accumulation of a guaranty fund of five per cent of the deposits of the state banks, out of which the depositors of failed banks should be paid the amount of their deposits as soon as banks closed, no matter whether the fund had reached the five per cent maximum or not. In case the accumulations in the fund should ever be insufficient to pay the deposits of any failed bank, interest bearing warrants were to be issued to the depositors. The conclusion from a study of the situation in 1909 was that any plan that provided for payment of depositors immediately upon the closing of the banks must fail, unless as a matter of simple luck failures should be very few until a large fund could be accumulated.[1] The luck has been the other way. The Oklahoma crops of 1910 and 1911 were poor. The crops of 1912, tho on the whole good, were not sufficient to restore the former level of prosperity. The year 1913, except in the cotton raising counties, has been unfavorable. The real estate boom that had been going on in many Oklahoma towns collapsed in 1910 and the succeeding years. Since the date of our former study, therefore, the state of Oklahoma has not enjoyed even average prosperity for the working out of the experiment of deposit guaranty.

No fewer than twenty-seven banks, with about $7,000,000 of deposits, have failed since the establishment of the guaranty system, or have been liquidated with the aid of the guaranty fund, and at least two others have required assistance from the guaranty fund. These failures, however, cannot be attributed to the

[1] Quarterly Journal of Economics, vol. xxiv, p. 340.

adverse agricultural conditions. Only three national banks have failed in Oklahoma during the same time. Many of the state bank failures must be due to recklessness and incompetence.

It will be remembered that the first guaranty law of Oklahoma was enacted immediately after the creation of that state, which includes what was formerly Oklahoma territory and also what was the Indian territory. The territory of Oklahoma had had a banking law and bank inspection while the Indian territory had not. It resulted that a great many banks that had never been supervised were thrown under the jurisdiction of the banking department of the state of Oklahoma. It was announced [1] that all were examined before the guaranty law went into effect, but this proves not to have been literally true. Results indicate also that the examinations were in many cases superficial and inefficient. The report of the Bank Commissioner about that time states that a large number of banks were technically not in harmony with every provision of the laws.[2] It was, however, felt by the state authorities that it would be unwise, and certainly it would have been unpopular, to put these banks out of business. Their deposits were, therefore, guaranteed and they remained a menace to the guaranty experiment. It is now said in Oklahoma that 75 of them were actually insolvent. This assertion cannot, of course, be verified; it illustrates the bad feeling caused by losses and consequent heavy assessments upon the solvent banks.

Perhaps the most unfortunate condition of all has been that for much of the time the state banking department was regarded as a part of a political machine. The department seems to have considered it necessary

[1] First Annual Report of the Bank Commissioner, p. viii.

[2] Ibid., p. ix.

to make a showing of success for the guaranty law, which was a political measure. When it was no longer possible to keep a bank open it was deemed essential to pay the depositors at once even if prudence would have dictated that time be taken for exact investigation of the situation. At the same time the Banking Board feared the political effect of levying on the solvent banks assessments sufficient to cover all failures as they occurred. It was believed, and was probably true that, if the limit of assessments, two per cent of deposits per annum, should be levied, the state banks would literally rebel. While the courts would undoubtedly have decided that the banks must pay the full assessments, in practice such assessments could not have been enforced. If the six hundred state banks had combined to resist such assessments, court decrees would not have amounted to much and the political prestige of Governor Haskell and his Bank Commissioners would have suffered irreparable injury.

Again, there have been more than a few cases of outright dishonesty in the administration of the banks. The present Bank Commissioner of Oklahoma has said that the heaviest losses of the past few years could have been avoided if more careful scrutiny had been given to the records of those who sought permission to organize and operate banks.[1] In a recent conversation this Commissioner, Mr. Lankford, told the writer that he had removed twenty bank officers and prosecuted sixteen others during his term.

Some rascals come into every new country and every new state at its settlement. That there have been bad men in Oklahoma banks will not surprise those who remember how Oklahoma was first settled by horsemen who lined up at the Kansas or the Texas

[1] Proceedings of the Oklahoma Bankers' Association, 1912, p. 91.

border and at a signal rode for the choice claims, nor those who remember that for years the Indian territory had not even a territorial government, justice being administered by the Indian tribes or by infrequent federal process. Good men predominated, of course. The wonder is that bad men have been so few and are being got rid of so fast.

Now a record of nearly thirty bank failures in five years, with almost all of them coming in three years, has not been equalled in the United States for a long time, the most recent parallel being perhaps the experience of some western states during and after the panic of 1893. The comparison holds good with respect to some of the Oklahoma failures. The greater number were simply a result of collapse after rapid settlement and exploitation, followed by a period of agricultural adversity, in a state where the records and the capacity of bankers were not closely investigated, and where bank examinations were in too many cases ineffective. These are not the cases, however, that have cost the guaranty fund any great part of the two million dollar loss.

It will be instructive to consider certain failures and see how they affected the guaranty fund, or have been affected by it. In November, 1910, the Creek Bank & Trust Company of Sapulpa failed. This was a crooked failure and one of the officers was sentenced to the penitentiary. September 10, 1912, there was another failure at Sapulpa, the Farmers and Merchants Bank, which one of the State Banking Board told the writer was the worst mass of filth he had seen in Oklahoma banking. Two of the officers were in jail for some time for failing to produce some of the books.

The Citizens Bank of Mountain Park failed in April, 1911. The last report of the Bank Commissioner says

that twenty-five thousand dollars of the notes held by the failed bank represented fraudulent transactions of the officers, who had been arrested and were then under bond awaiting trial.[1]

The Bank Commissioner took charge of the Night and Day Bank of Oklahoma City, June 7, 1911. This was one of a chain of Night and Day Banks operating in Memphis, Tennessee, Kansas City, Missouri, and Little Rock, Arkansas. Another bank in Hot Springs was also in the chain. Abner Davis, President of the Oklahoma City institution, was convicted in the United States Court at Memphis, in October, 1912, with five others, for misuse of the mails in the furtherance of fraudulent bank schemes. He went to old Mexico, and there was a rumor that he was thrown into jail there for some other reason. The following amusing incident is here set down for any bearing it may have on the quality of some Oklahoma examinations a few years ago. A banker who was then a state bank examiner in Missouri tells the writer that he was in Oklahoma City to gather some information bearing on the Kansas City institution, and that one of the Oklahoma examiners was assisting him by looking over the books of the affiliated Oklahoma City bank. The Oklahoma City examiner came back to the hotel and told the Missouri examiner that everything must be all right, that Abner Davis had $30,000 on deposit in the Night and Day Bank of Oklahoma City. The Missouri examiner told him he had better go back and look again and make a thoro investigation of that account. The Oklahoma examiner insisted, however, that he was correct. When the bank closed a short time later it developed that the $30,000 was not a credit, but was an overdraft, and that the

[1] Third Biennial Report of Bank Commissioner, p. xiv.

examiner had been deceived because the amount had been carried on the books in black ink instead of red.

This bank finally cost the guaranty fund about $400,000. The efforts of the Banking Board to save the bank by guaranteeing its assets to successive purchasers are told below.

The Farmers State Bank of Tushka was closed in September of the same year. It cost the Fund $26,000 and the cashier committed suicide as soon as the State Bank Examiner took charge.[1]

The First State Bank of Pryor lost its capital of $30,000 and $30,000 besides, but the stockholders made good the loss to depositors. This failure, therefore, cost the guaranty fund nothing.

The administration of the banking department during this time of numerous bank failures has been, of course, a matter of extreme difficulty. The law contemplated, and politics demanded, that the depositors be taken care of at once. Yet with failure after failure coming, and with the banks rebelling against the intolerable assessments, it seemed necessary to resort to most astonishing expedients. The provision of the law applicable was the following:

" If the amount realized from such emergency assessments shall be insufficient to pay off the depositors of all failed banks having valid claims against said depositors' guaranty fund, the State Banking Board shall issue and deliver *to each depositor* having any such unpaid deposit, a certificate of indebtedness for the amount of his unpaid deposit, bearing six per cent interest." [2]

Instead of closing insolvent banks, however, and issuing such warrants to depositors, the State Banking

[1] Ibid., p. xviii.

[2] Banking and Trust Company laws of Oklahoma, effective June 11, 1909, Art. II, Sec. 2. Italics are the writer's.

Board resorted to all kinds of schemes to keep the insolvent banks running, hoping against hope that they might be restored to solvency or that actual collapse might be avoided until the fund could be replenished sufficiently to take care of the depositors. For these reasons the Board borrowed money in Oklahoma and elsewhere, issuing warrants therefor against the guaranty fund. In the opinion of the writer authority for such warrants existed nowhere in the law either specially or by implication. Further, the Board has bought securities from banks in a critical condition in order to provide such banks with cash; has made deposits in other failing banks; and has frequently induced one bank to take over the business of an insolvent bank by guaranteeing to the solvent bank the assets of the insolvent bank. Such efforts to postpone the evil day do not often succeed. They are far more apt to be a throwing of good money after bad, and such procedure has been bitterly criticised by the solvent state banks, who believe that their assessments to meet failures have been greatly increased by the temporizing policy of the Banking Board.[1]

The first great test of the Oklahoma guaranty law, it will be remembered, came with the failure of the Columbia Bank & Trust Company of Oklahoma City late in 1909. That still remains the greatest failure that has occurred in Oklahoma banking, both from the point of view of the amount of deposits involved and from the point of view of loss to the guaranty fund.

In the former study of the guaranty of bank deposits it seemed necessary to criticise the procedure of the Oklahoma Banking Department in beginning to pay depositors without any adequate inquiry into the extent of the failure. It now appears that the department

[1] Proceedings of the Oklahoma Bankers' Association, 1912, p. 77.

was even more reckless than was then supposed, and that it did not even first prove the amount of notes and securities on hand, much less their value. The result was that when an attempt was made to take a proof some three days after the failure there was a discrepancy between the books and the notes of more than $70,000. It proved impossible to locate the discrepancy, because essential records, including the discount ledger and general cash journal, had absolutely disappeared. So far as the writer is aware they have never been discovered.

A sale of certain securities to Cobe and McKinnon of Chicago was arranged for the sum of $300,000 and up to January 30, 1911, $248,000 had been received from Cobe and McKinnon by the Banking Board. Cobe and McKinnon, however, were at that time claiming large sums from the Banking Board on account of the failure of title to certain items which they had included in their bid. On the other hand, the cost to the Banking Board of releasing from liens and from possible bankruptcy proceedings such notes and securities as it had actually delivered to Cobe and McKinnon had been $194,000, or within $54,000 of the whole amount the Board had received.[1] The writer is informed that litigation over the claims of Cobe and McKinnon is still pending. This one failure has cost the Oklahoma banks $600,000. Almost worse than the actual loss have been the suspicions and recriminations aroused by the incidents of the failure and the liquidation.

In January, 1911, the Banking Board made a sale of 460 shares of stock of the Night and Day Bank of Oklahoma City to C. J. Webster and his associates with the agreement that the $46,000 paid in by Webster should be considered an asset of the bank, which, with

[1] Report on Oklahoma State Guaranty Fund by Arthur Young and Co., p. 73.

surplus and profits, should be kept in a separate account known as an "indemnity account," to be used from time to time to indemnify C. J. Webster and his associates against any loss of any kind whatever due to impairment of capital or insufficiency or insolvency of notes or other securities or against any discrepancy in the accounts. The sum of $60,000 was left on deposit by the Banking Board as additional security to Mr. Webster, and the bank was kept running. Later the bank was taken over by the Wilkin-Hale State Bank of Oklahoma City, the Banking Board taking all doubtful assets not accepted by the Wilkin-Hale State Bank and paying the latter the difference between the liabilities assumed and the assets taken. This difference was paid largely in warrants which were themselves only paid this year. The cost to the Banking Board in liquidating the Night and Day Bank had been, to January 1, 1913, $366,000.[1]

The Planters and Mechanics Bank of Oklahoma City was allowed to run long after its desperate condition was known. This was one bank from which the Banking Board purchased certain securities in an effort to keep it going. As early as July, 1910, the Banking Board was depositing money in it, and was buying securities from it, in an effort to strengthen its reserve.[2] The bank was not closed, however, until April 6, 1911. Bankers expect the failure to cost the guaranty fund about $300,000.

At Durant, the Banking Board deposited $25,000 in the Guaranty State Bank as security against any loss it might sustain in liquidating the Oklahoma State Bank.

[1] Third Biennial Report of the Bank Commissioner, p. xv.

[2] Report on Oklahoma State Guaranty Fund by Arthur Young and Co., p. 77.

At Muskogee, the Alamo State Bank took over certain assets of the Oklahoma Trust Company, and assumed certain liabilities. Later it was reported that the Alamo State Bank was itself not in a condition to continue business without additional capital. The Union State Bank was therefore organized to take over the business and to it the State Banking Board paid $40,000 as a part of its capital, the Board holding the shares as security for its advances.[1] The load has proved too heavy for the Union State Bank and it has just been closed (September 13, 1913).

At Sapulpa and Ochlelata new banks were organized to assume the deposit liabilities of failed banks, under guaranty of assets by the State Banking Board. At Oklahoma City in a recent case the Banking Board issued a large amount of warrants to enable a failing bank to continue in business under a new management. This case was in the mind of a banker who said in substance at the meeting of the State Bankers' Section of the Oklahoma Bankers' Association last May: "There will be a meeting of the Executive Committee after the close of this session. I want the state bank examiners who are present to remain for that meeting. I want them to explain how it is possible for a bank under their jurisdiction to fail for $140,000."

This bank illustrates some vicious tendencies of bank deposit guaranty unsupported by the strictest control of bank organizations. Its president was a man who years ago established a small bank in Oklahoma City and so failed to win the confidence of the community that he finally went out of business. Under the guaranty system he went into business again on a much larger scale. He obtained deposits of about $300,000, and

[1] Report on Oklahoma State Guaranty Fund, p. 91.

it has cost the Banking Board about $190,000, less salvage, to save the depositors.

Still another Oklahoma City case took $30,000 out of the guaranty fund. It is astonishing what a heavy proportion of all the losses has occurred at Oklahoma City. An Oklahoma City banker estimates the losses to the fund in his own city at $1,670,000 (the exact cost depends on the result of the liquidations). This may be high, but at any rate approximately three dollars out of every four the fund has lost have been lost in Oklahoma City, the metropolis and now the capital. The effect of unfavorable economic conditions has been cumulative upon those banks at the capital that from recklessness or inexperience have not been able to keep clear of bad paper, or in one case perhaps have not tried. It has been already pointed out that an inevitable effect of a state-administered system of deposit insurance, or guaranty, is that the state cannot limit the size of single risks. Nor can it avoid the "conflagration hazard" by fixing a maximum of risk that it will assume in a single locality.

The cases described sufficiently illustrate failures and liquidations. They are a sorrowful story, even tho not all failures were dishonest and not all liquidations wasteful. The procedure of the Banking Board in many cases where banks were in difficulty seems to the writer outside the law as it existed before the last session of the legislature. The law contemplated that the Banking Board should pay the depositors after failure, not that the Board should try to avert failure by depositing money in failing banks, buying their securities or guaranteeing their assets. How competent business men could do such incredible things can be explained in only one way. To repeat, these expedients were resorted to under the pressure

of real or supposed necessity, that of preventing the actual closing of the banks in such numbers as to break down the guaranty system. The writer was present this year at the meeting of the State Bankers' Section of the Oklahoma Bankers' Association. One of the new members of the State Banking Board nominated by the State Bankers themselves arose and said that he had formerly been of the opinion that the effort to keep insolvent institutions going was wrong, but that since becoming a member of the State Banking Board and having an opportunity to look at things from the inside he was not sure that there had been any other way. He was of the opinion, however, that it would be no longer necessary to postpone the closing of insolvent banks, because the new Oklahoma law adopted this year provides for smaller maximum assessments than before, and so seems to contemplate a condition wherein the issue of warrants to pay depositors of failed banks may be regarded as for the present the normal method of making such payment.

This brings us to a consideration of Oklahoma legislation since the article in this Journal three years ago. In 1911, there was an amendment of the guaranty act providing that trust companies should not have the benefit of the act and providing that the guaranty fund, when collected, should be deposited with the bank by which it was paid, and that a special certificate, or certificates, should be issued therefor to the Bank Commissioner, such certificates bearing interest at 4 per cent per annum. Changes made by the act of 1913 have been very important. The state banks had found intolerable a condition under which they had been assessed four and one-half per cent of their deposits in five years, and they told the politicians that if they would place

the State Banking Board in the hands of the bankers themselves, the bankers would serve without salary. The act, therefore, provides for the organization of the State Bankers' Association with one representative from each bank. This association nominates three persons from whom the Governor is to choose the Bank Commissioner and nine persons from whom the Governor is to select three other members of the Banking Board. The Commissioner and the three other members so selected are the Board. This is the first instance in America of conferring upon a Bankers' Association the power of making nominations for public offices.

The three members of the Banking Board selected by the Governor from the nominees of the Bankers' Association are John J. Gerlach, A. D. Kennedy, and W. F. Barber, all recognized as sound and experienced bankers.

Under the act of 1909, the Banking Board had authority to levy emergency assessments up to two per cent of the average daily deposits, but the Board had never dared to make emergency assessments exceeding one per cent. It is now provided that the regular assessments of one-fifth of one per cent of deposits shall not be exceeded except in the fiscal years 1914, 1915 and 1916, when the assessments may reach two-fifths of one per cent. Oklahoma State bankers are inclined to regard this as a great improvement in the law. It may be doubted, however, whether any law which diminishes the amount of taxation permissible for the replenishment of an insolvent fund can be regarded as an improvement. It is significant that the permanent guaranty fund to be accumulated is now reduced to two per cent of deposits instead of five, altho practically neither amount could be reached for years, if ever.

The new law follows the Nebraska law in not collecting the assessments until they are needed. Nebraska banks enter the amounts of the assessments on their books to the credit of the State Banking Board. Oklahoma banks pay with cashier's checks, not bearing interest, and the checks are to be held by the Banking Board till needed. It is not an element of strength in any insurance scheme to leave the collection of premiums until a loss occurs. One supposes that cashier's checks are taken instead of book credits in the belief that bankers objecting to assessments would pay their own cashier's checks, when they might possibly refuse to pay drafts by the Banking Board against a guaranty account set up on the bank's ledger. To secure its liabilities to the Depositors' Guaranty Fund, every state bank is now required to deposit with the Board bonds or warrants equal to one per cent of its deposits, but not less than $500 in any case. Some banks have refused to do this, but have not yet been closed for refusing.

Guaranty Fund Warrants can now legally be issued to any concern that will take them instead of merely to depositors of failed banks, as the law read before. That is, the Board can borrow money and so pay depositors in cash. State bankers, therefore, say that they have funded their debt. To make a market for the warrants, they are made legal security for public funds and for any deposits which foreign corporations are required to make in the office of the State Treasurer. Further, they are made non-taxable for any purpose whatever. Any bank may deduct its holdings of Depositors' Guaranty Fund Warrants when returning its capital for taxation. Such are the means employed to bolster up the paper of the guaranty system.

The criminal provisions of the banking laws were greatly strengthened because it had been found in practice almost impossible to obtain convictions for bank wrecking. Juries are sympathetic because, up to date, no depositor of a state bank has lost any money; and since no one in the community has lost anything the atmosphere is not favorable to the administration of punishment.[1]

These constantly recurring losses in Oklahoma City and elsewhere, aggregating $2,000,000, have made it necessary to assess the state banks an average of one per cent per annum on their deposits, a total of about $1,750,000. Yet the fund owed in June some $418,-926.56 of unpaid warrants with only $35,000 on hand.[2] Now one per cent of deposits is from four to seven per cent of the capital of the average Oklahoma state bank, depending on the season. Such a recurrent drain in lean crop years has become unendurable. To bring this home, the following table gives special instances told the writer, the names of the banks affected being, of course, omitted.

In four years one bank with			$50,000	capital	paid	$13,000	in	assessments
"	"	"	50,000	"	"	10,000	"	"
"	"	"	50,000	"	"	15,000	"	"
"	"	"	10,000	"	"	1,300	"	"
"	"	"	15,000	"	"	3,000	"	"
"	"	"	5,000	"	"	2,255	"	"
"	"	"	30,000	"	"	20,000	"	"

[1] "B. C. Burnett, 'Not Guilty,'"—"After a somewhat strenuous trial B. C. Burnett, one of the officers of the failed Sapulpa Bank, was declared not guilty. The bank was in bad shape about three years and was permitted to remain open by the banking board to reduce the Guaranty Fund liability, which was done. The verdict of the jury is in line with several other verdicts which established the belief that it is practically impossible to convict a banker on a loss to the Guaranty Fund. However, the Burnett case was not tried under the new law passed by the last legislature which is far more explicit and stringent than the old one." Oklahoma Banker, vol. IV, p. 370.

In Kansas the situation is very unlike this. There a banker accused of crime is thought to have very little chance with a jury.

[2] Letter from the Bank Commissioner.

The manager of the first bank in the table said to the writer: "That $13,000 would look good now, if I had it in my surplus account." The last bank in the table has since found it necessary or desirable to merge with another institution.

Many bankers have not been satisfied to wait under such crushing burdens for the enactment of legislation limiting the emergency assessments for the guaranty fund. From January 1, 1910, to April 21, 1913, 101 state banks in Oklahoma entered the National System. A few banks had already taken this step by the opening of 1910. Only 7 more followed in that year, altho the liquidation of the Columbia Bank and Trust Company and the emergency assessment levied in connection with that failure were bitterly resented. In January, 1911, the decisions in the guaranty cases were announced and in March, a further emergency assessment of one per cent was made. During 1911, therefore, no fewer than 65 banks nationalized. The movement continued all through 1912, when 21 banks left the state system. There has been no sign of a weakening of this tendency this year, 8 banks having nationalized up to April 21st.[1] Many thought to escape assessments already levied, but the courts hold that national banks are liable for assessments levied upon them before their nationalization and while they were yet state banks. It is announced that suits will be filed to collect such levies. These 101 banks have a total capital of more than $3,500,000, and the loss to the state system is very considerable. Besides the banks that have converted or reorganized, 10 banks, to the close of 1912, have consolidated with existing national banks. Twenty-eight of the 101 banks nationalized and 3 of the state banks that consolidated

[1] Letter from the Comptroller of the Currency.

with national banks had themselves been conversions from the national system. One of the most striking incidents of the early years of the Oklahoma experiment was the large number of banks that left the national system and entered the state system because of the increase in deposits that was observed to accrue to state banks. It is interesting to see how many of these and how many of the other state banks found the burden of guaranty assessments intolerable.

According to the reports of the Bank Commissioner, some 50 other state banks left the state system between January 1, 1910, and January 11, 1913, by liquidating or by consolidating with other state banks.

It must not be thought that all state banks have nationalized that could do so. The Bank Commissioner's report published last December shows 113 state banks with capitals of $25,000 or more, all of them, that is, large enough to enter the national system. Doubtless some of them were otherwise not in condition to nationalize, but many, or most of them, could have done so if their officers had believed the change advantageous. Of course the little banks with capital of $5000 to $20,000 cannot ordinarily nationalize without raising more capital than it is convenient for their stockholders to supply, or more than their business requires. Many banks remain in the state system, and many new state banks are organized, despite the guaranty taxes.

The reports of the Bank Commissioner show that from January 1, 1910, to November 26, 1912, 114 state banks were organized with $1,987,000 capital. New banks were organized at almost as rapid a rate during the first half of the present year. There is a craze to "start banks," and they are being organized in excess of economic need. The Bank Commissioner said a year ago that there were on file more than 300 appli-

cations for state bank charters.[1] In view of the ease with which new banks obtain deposits, their deposits being guaranteed, the numerous applications for charters were regarded as a public danger. The Commissioner, without authority, had denied some applications, and the legislation of this year has put the issuance of bank charters entirely in the discretion of the Commissioner and the Banking Board. This provision is liked by the bankers, who see danger in the organization of numerous weak banks. Certainly no one will quarrel with rigid investigation of every applicant for a bank charter. His experience, ability, and integrity should be established conclusively. But when a man of experience, ability, and integrity desires to establish a bank in a given locality, is it for any public officer to deny him the right to do so? If the organization of the bank would be a business mistake, and an unprofitable venture, has not our country grown and prospered by allowing its citizens the privilege of making their own ventures and their own mistakes? The same considerations apply to the fixing by the Bank Commissioner of the maximum rate of interest on deposits. This is done in Kansas and Oklahoma. The object is the prevention of reckless overbidding. The result is a "fixing of prices," an interference with the freedom of contract, such as has been thought unwise in modern times.[2]

[1] Proceedings of the Oklahoma Bankers' Association, 1912, p. 87.

[2] The maxima fixed by the Bank Commissioner of Oklahoma are:

3% on accounts of banks, insurance companies, etc.
3% on certificates of deposit 90 days or more.
4% on certificates of deposit 6 months or more.
4% on savings accounts.
No interest on checking accounts, except 3% on public funds.

The following table shows the drift first to the state guaranty system and then to national banking (in $1000): —

ITEMS IN ROUND AMOUNTS FROM OKLAHOMA BANK STATEMENTS

State banks[1]	*Feb. 29, 1908*	*Nov. 16, 1909*	*Jan. 31, 1910*	*Jan. 7, 1911*	*Feb. 20, 1912*	*April 4, 1913*	*Aug. 9, 1913*
Number of banks	470	662	668	695	628	606	596
Capital	6,233	10,767	10,679	11,570	9,841	9,079	8,867
Surplus	580	881	1,079	1,386	1,163	1,126	1,162
Due to banks	476	4,537	4,142	5,692	2,436	2,251	2,124
Individual deposits[2]	18,032	49,775	49,928	54,756	39,391	42,629	40,181
Due from banks	7,529	20,659	17,670	25,129	12,380	14,217	11,779
Cash	2,078	4,607	4,092	4,625	3,137	3,057	2,614
National banks	*Feb. 14, 1908*	*Nov. 16, 1909*	*Jan. 31, 1910*	*Jan. 7, 1911*	*Feb. 20, 1912*	*April 4, 1913*	*Aug. 9, 1913*
Number of banks	312	220	219	229	283	314	326
Capital	12,215	10,070	9,927	10,745	12,915	13,720	14,330
Surplus	3,063	2,674	2,736	2,925	3,279	3,632	3,933
Due to banks	4,416	8,263	7,166	11,161	7,503	10,329	8,855
Individual deposits[3]	38,298	41,617	43,112	47,651	53,094	67,329	67,753
U. S. Deposits	1,789	765	693	770	1,083	1,225	996
Due from banks	14,801	16,657	15,260	20,934	17,973	25,210	21,165
Cash	5,878	4,968	4,780	5,625	5,243	6,610	6,247

[1] Includes trust companies.

[2] Does not include cashier's and certified checks.

[3] Includes cashier's and certified checks.

The state system, beginning with 470 banks and $25,000,000 of deposits in 1908, when the guaranty legislation went into effect, grows rapidly in number of banks and in business for three full years, until the state banks number 695 and the deposits amount to $60,000,000. Even the failure of the Columbia Bank and Trust Company in September, 1909, does not stop the organization of new banks and the conversion of national banks into state institutions. The national banks fall off nearly 100 in number, and the deposits of those remaining show only a normal growth.

The national banks, however, begin to gain in numbers and deposits a year before the state banks begin to lose, in fact while the latter are still gaining. There were 219 national banks in January, 1910, and 326 in August, 1913. Their deposits grew from $50,000,000 to $76,000,000. So many state banks left the state system, and so many liquidated or failed, that the 695 of January, 1911, fell to 596 in August, 1913, while deposits decreased from $60,000,000 in the former year to $42,000,000 in the latter. Part of the growth of the state system from 1908 to 1911 partook of the nature of a craze. Another part was due to the inflation of loans. Much of it was sound, legitimate growth, which, as the table shows, has been maintained. There are 126 more state banks in Oklahoma than when the guaranty system went into operation, and their deposits are $17,000,000 greater. Subsequent developments have not invalidated this conclusion stated four years ago: " Given assurance (of the safety of deposits) which it considers adequate, the public will make greater use of banks and more banks will be established."

In spite of all the failures, the people of Oklahoma have not lost faith in deposit guaranty as there administered. People have left deposits in banks that they

knew would fail. After failure many depositors have to be reminded, some of them repeatedly, to call and get their money. One of the members of the Banking Board, who was in Sapulpa when a bank failed there, says that a dog fight in the street would have drawn a bigger crowd. The people have experienced no losses from the state bank failures of the last five years. They refuse to worry over failures present and to come. It is not good for a community that under its banking system the depositor takes no thought whatever for the safety of his deposit.

Many bankers would like to see the guaranty law repealed, but recognize that repeal is for the present hopeless. Meantime they want the state to pay part of the excessive losses they have sustained in assessments for the fund. The Bank Commissioner favors having the state pay any losses in excess of the regular annual assessment of one-fifth of one per cent. He says banks would get better results in the courts if the tax-payers had a direct interest in the enforcement of the banking laws.[1] One of the members of the Banking Board issued a circular letter this year, in his private capacity, stating that the Governor of Oklahoma, Mr. Cruce, had recommended that the state should help in defraying the extraordinary expense the guaranty system had brought upon the banks. The circular called upon the banks to inaugurate a campaign for such relief.

Is this to be the end? Will the state of Oklahoma decide that the guaranty of bank deposits is impracticable, discontinue the guaranty fund, and assume its liabilities? There is little discussion of such an outcome now, but obviously the state must in some way stop the terrific drain on its banks. The boldest optimist cannot hope that the drain will cease of itself.

[1] Proceedings of the Oklahoma Bankers' Association, 1912, p. 91.

Recurrent failures and rumors that some other banks are unsound in a year when short crops make collections slow indicate little chance for the guaranty fund to pay its debts and gain a working balance. After collecting assessments of $1,778,849.36 from the beginning of the system in 1908 to May 1, 1913, the State Banking Board had warrants outstanding June 1 of $418,926.56, with only about $35,000 cash on hand.[1] Abandonment or reconstruction, there are no other ways. Which of these courses will be followed depends on which takes the popular fancy, and that in turn depends on which has the most attractive advocacy. Prediction is futile.

The plan has failed, to repeat, because the loss experienced has far outrun the theoretical ratio. The reasons of the heavy losses, as they have been narrated in the foregoing discussion, may be here summarily restated: (1) The Banking Department was for a long time in politics. (2) Unsound banks were admitted and guaranteed at the outset. (3) The record of bankers has not been properly traced. (4) There has been procrastination in closing insolvent banks and timidity in the face of losses. (5) Economic conditions have been somewhat adverse. (6) The guaranty of deposits has relieved depositors of all necessity for care in selecting banks.

The first four of these reasons are not arguments against deposit guaranty, because they arise from conditions that can be corrected. Politics can be measurably eliminated from the administration of state banking departments. The records of men who wish to organize banks can be found out. Reasonably efficient bank examinations can be had, and weak banks can be closed without the wasteful temporizing that we have seen in Oklahoma. Can any guaranty plan,

[1] Letters from Hon. J. D. Lankford, Bank Commissioner.

however, withstand seasons of bad crops, and can any plan, otherwise adequate, maintain the interest of the depositor in the soundness of his bank? It is by these tests that the guaranty principle must stand or fall. A heavy presumption arises against the principle because of the failure of its application in Oklahoma. We cannot insist upon this presumption, however, until we have compared Oklahoma with the other states, whose guaranty systems have so far not collapsed. In the course of such comparison we may conjecture whether Oklahoma depositors would have retained interest in their banks if the law had provided that in the event of failures depositors should be paid only after the affairs of the banks had been wound up.

II. Kansas

At the time of our discussion four years ago, the enforcement of the Kansas Guaranty Act had been temporarily enjoined. The injunction was dissolved by the United States Circuit Court of Appeals, and operations under the Act were resumed in 1910, altho it was not until 1911 that the case was finally decided by the Supreme Court.

Participation in the guaranty is optional with the banks, and only one guaranteed bank has failed. That was the Abilene State Bank, which was closed in September, 1910, wrecked by the defalcations of its cashier, who is now in the state penitentiary. The Kansas plan wisely provides that depositors shall not be paid until all assets, including the stockholders' liability, have been realized upon so far as possible, and the affairs of the bank wound up. In the meantime, certificates of indebtedness are issued to the depositors. In the Abilene case certificates amounting to $46,809.75

are held by the creditors, or rather in most cases have been sold to the other Abilene banks. The other banks were satisfied to take them in order to get the business of the depositors of the failed bank, particularly as the certificates bear six per cent interest.

The assessments for the Kansas Guaranty Fund are very small. One twentieth of one per cent per annum is levied on the amount of deposits of each participating bank, less its capital and surplus. This encouragement to the provision of a substantial capital and the accumulation of a good surplus is wise; and the framers of the law fixed small assessments, believing that since losses were only payable after final liquidation, it would be unnecessary to build up a large fund soon. Besides the regular assessment, however, four emergency assessments can be levied any year, making a total of one-fourth of one per cent.

A fund has now been accumulated of $111,159.54 and the banks have deposited $355,977.10 in municipal bonds, school bonds, and the like to guarantee the payment of future assessments. Such deposits are required in the amount of $500 of bonds for every $100,000 of deposits.

Rather more than half the state banks take advantage of the possibility of having their deposits guaranteed, which is virtually to insure them in the State Guaranty Fund. The figures in June of this year stood as follows: [1]

	Number	Capital	Deposits
Guaranteed Banks	472	$9,979,800	$71,040,906
Unguaranteed Banks	446	8,327,500	42,707,937

Some changes have been found necessary in the law. The provision excluding from the guaranty deposits

[1] Letter from the Bank Commissioner.

bearing interest, and excluding from participation in the plan banks paying more than three per cent interest on any class of deposits have been found too stringent.[1] The law now provides that all deposits not otherwise secured shall be guaranteed. It provides further that the Bank Commissioner shall fix for each county a maximum rate which the banks in that county may pay on deposits. The Commissioner has fixed rates varying from three to five per cent, since the Kansas counties differ widely among themselves in resources and capital.[2] Any bank officer who shall pay interest in excess of the rate fixed by the Commissioner, or on different terms than he prescribes " shall be deemed to be reckless, and may be removed from office as provided by law." [3]

The rate on certificates issued to depositors in case of insolvency remains six per cent, in the case of deposits that bore no interest. In other cases, the warrants bear the same rate the depositor was to receive under his contract with the bank. As the law stood originally, the holder of a three per cent certificate of deposit would receive six per cent after the failure of the bank.[4]

Banks whose entire deposits are guaranteed, either by the Bank Depositors' Guaranty Fund of the State of Kansas or by a surety company, are now relieved from giving further security for public deposits, except the deposits of the state itself.[5]

It will now be well to examine the relative progress of the state and national banks in Kansas during the

[1] See Quarterly Journal of Economics, vol. xxiv, p. 351.

[2] William Allen White says in The Real Issue — " Kansas, like Gaul, is divided into three parts." These parts correspond to the Commissioner's classification of 3, 4, and 5 per cent counties.

[3] Laws of Kansas, 1911, chap. 61, secs. 1 and 2.

[4] Ibid., chap. 62.

[5] Ibid., chap. 63.

time it has been possible for the state banks to have their deposits guaranteed.

BANK ORGANIZATIONS

	State Banks Organized		State Banks Nationalized	
	Number	Capital	Number	Capital
Two years ending Sept. 1, 1910	128	$2,173,000	4	$79,500
" " " Sept. 1, 1912	56	1,061,000	5	100,000

NATIONAL BANKS ORGANIZED

(Including Conversions of State Banks)

	Number	Capital
Year ending Oct. 31, 1909	5	$315,000
" " Oct. 31, 1910	5	165,000
" " Oct. 31, 1911	4	120,000
" " Oct. 31, 1912	2	55,000

ITEMS FROM BANK STATEMENTS IN ROUND AMOUNTS

State Banks	*Sept. 29, 1909*	*Sept. 4, 1913*
Number of banks	819	928
Capital	$15,810,000	$18,995,00
Surplus	4,957,000	7,717,000
Deposits	97,217,000	118,170,000
Cash and due from banks	36,528,000	42,023,000

National Banks	*Nov. 16, 1909*	*Aug. 9, 1913*
Number of banks	206	213
Capital	$11,992,000	$12,312,000
Surplus	4,887,000	6,149,000
Deposits	83,785,000	88,255,000
U. S. Deposits	651,000	1,031,000
Cash and due from banks	28,960,000	31,088,000

The increase in the number of state banks is striking. The guaranty system may have been an influence in the organization of some of the new banks, but rarely the moving cause. Deposits are not guaranteed until banks are a year old. Most of the new banks in Kansas, as well as in other Western states, are small institutions, so small that they could not have entered the national

system. The typical capital of a new bank continues to be $10,000, altho, of course, state banks are chartered occasionally with much larger capital. Deposits in national banks increased fully as much as in state banks between 1909 and 1913, and, by proportion more, altho in the meantime the largest national bank in Kansas had moved a few hundred yards into Missouri.

Many of the national banks and a few of the state banks have insured their deposits in the Bankers' Deposit Guaranty and Surety Company of Topeka, a corporation originally formed largely to counteract the influence of the state guaranty law, which was expected to attract business to state banks. The Company is not pushing the deposit insurance feature of its business, however, altho it has never had a loss. It is understood to insure the deposits of about 100 banks, practically the same number it insured three or four years ago.

It is significant that the number of banks participating in the Depositors' Guaranty Fund is increasing.[1] The fact that they cannot participate for a year after they are organized means that the banks now coming into the scheme have decided, after opportunity to consider the matter, that the guaranty of their deposits by the state fund will increase their deposits somewhat, or make their deposits rather more stable, or both. It is not that the sign "Deposits Guaranteed by Bank Depositors' Guaranty Fund of the State of Kansas" draws business in quantity from the other banks, as it did in Oklahoma in the first year or two of the experiment. It is that occasionally a deposit comes in from a man who, the cashier knows, would not have patronized the bank if its deposits had not been under guaranty. Or a deposit remains for a time whose

[1] Letter from the Bank Commissioner.

owner would have made haste to use it in the days when every bank lived to itself alone.

If any system of insuring deposits in a fund administered by the state is to endure, it should have some of the features of the Kansas guaranty plan. The allowance for capital and surplus and the payment of depositors at the final liquidation only are admirable. It is unwise that the Guaranty Fund should be limited to $500,000, for there are many single banks in Kansas with deposits larger than that sum, and half a million is too small a reserve for $70,000,000 of risks. It is still more unwise that the assessments while the fund is being accumulated should be only one-twentieth of one per cent per annum. That rate is theoretically good, but it builds up the fund far too slowly.

Further comments on the Kansas scheme can best be made after a study of Nebraska and Texas.

III. Nebraska

It is now fifteen years since a national bank failed in Nebraska. It is eight years and more since a state bank failed, and then the depositors lost only $2,000. "In Nebraska," writes Mr. E. R. Gurney of Fremont, a keen observer, "we have a population of mixed races, a very large percentage, however, running to foreign born. These foreign people are hard working, economical and almost always good pay. Their notes in most any bank can be approved. Moreover, our state has reached an age where stability is the rule, and more than all other circumstances, is the fact that we have had a capable and vigorous administration of our State Banking Department for something like fifteen years past. Our banks, therefore, are sound from the standpoint of the assets and also from the influence of supervision."

It is true that in many Western states, the foreign born farmers are regarded as more certain payers than the Americans. Less venturesome, they are sometimes better risks for the banker, even if, or probably because, they are satisfied with modest results. If they develop a country less rapidly than Americans develop it, their progress is steadier and their notes in bank are not subject to so many vicissitudes.

What Mr. Gurney says of the Nebraska Banking Department is also true. The Secretary of the Board, Mr. Royse, has done such excellent work that the changing state administrations of ten years have wisely kept him continuously in office.

The time when the Nebraska deposit guaranty act of 1909 was to take effect had not arrived when the United States Circuit Court enjoined the state officials from putting it into operation. The Act was upheld by the Supreme Court, however, with the Oklahoma and Kansas statutes, and the first assessment was collected July 1, 1911.

The legislature had made a few amendments in April, but the working plan was essentially that adopted in 1909. There were four semi-annual assessments of one-fourth of one per cent of average deposits. The last of these was paid January 1, 1913. Further assessments are one-twentieth of one per cent semi-annually, as originally provided. New banks still pay one per cent of their average deposits the first year. It is now provided that when the Guaranty Fund reaches one and one-half per cent of the deposits of the state banks, assessments shall cease until the fund is depleted below one per cent of deposits. To correct an ambiguity, the act of 1911 provided that no bank which had paid the assessments and otherwise complied with the banking laws should be required to give any further security

for public deposits. This is different from the Oklahoma plan, where special security is given and deposits specially secured are not within the guaranty.

The only important amendment adopted this year permits the investments of a bank to equal ten times its capital and surplus, instead of eight times, which was the limit fixed in 1909.

The original act of 1909 prohibited private banking and required the thirteen private banks to procure state charters or discontinue business. It made the guaranty scheme obligatory upon all state banks. These provisions are unchanged.

Where economic conditions are settled and banking stable, it is not to be expected that changes in the banking laws will effect a marked change in the disposition of accounts. Nevertheless, the reports of Nebraska banks since the United States Supreme Court decision (January 3, 1911) make an interesting study. Important items from the reports of state and national banks a year before and just after the decision are here presented in comparison with the reports of August, 1913.

ITEMS FROM BANK STATEMENTS IN ROUND AMOUNTS

State Banks	*Feb. 12, 1910*	*Feb. 17, 1911*	*Aug. 26, 1913*
Number of banks	664	668	710
Capital	$12,362,000	$12,729,000	$14,380,000
Surplus	2,245,000	2,427,000	3,264,000
Deposits	77,991,000	74,105,000	94,194,000
Due from banks	18,726,000	19,960,000	22,924,000
Cash in banks	4,452,000	4,476,000	4,889,000
Depositors' Guaranty Fund			811,000

National Banks	*March 29, 1910*	*March 7, 1911*	*Aug. 9, 1913*
Number of banks	227	237	241
Capital	$14,810,000	$15,695,000	$16,270,000
Surplus	6,035,000	6,784,000	10,319,000
Deposits	121,283,000	119,087,000	128,663,000
U. S. Deposits	1,060,000	1,035,000	1,241,000
Due from banks	29,479,000	33,006,000	34,103,000
Cash in bank	10,726,000	10,477,000	11,682,000

For a year before the decision was announced state banks had been nationalizing, some of them undoubtedly for the purpose of escaping the assessments. Thirteen state banks took out national charters in 1910, and 11 nationalized in 1911.[1] On the other hand, new state banks were organized pretty freely, with an eye to the prestige of guaranteed deposits. Nationalization has now ceased, for there was not an instance in Nebraska in 1912; but the organization of state banks continues.

BANK ORGANIZATIONS

	State Banks Chartered		State Banks Nationalized	
	Number	Capital	Number	Capital as State Banks
Nov. 16, 1909 to Nov. 10, 1910	28	$420,000	13	$630,000
Nov. 10, 1910 to Dec. 5, 1911	24	492,000	11	420,000
Dec. 5, 1911 to Nov. 26, 1912	27	775,000	0	0

NATIONAL BANKS ORGANIZED

(Including conversions)

	Number	Capital
Year ending Oct. 31, 1910	20	$880,000
" " Oct. 31, 1911	12	1,195,000
" " Oct. 31, 1912	1	25,000

On account of nationalizations and liquidations, the state banks lost ten in number between the February and June reports in 1911, at the time the guaranty law was going into effect, and their deposits fell off more than $2,000,000. From March to June of that year the national banks increased by eight, and their deposits by $1,400,000. Since that time the state banks seem to have been somewhat preferred. The table shows that they have gained forty-two in number and $20,000,000 in deposits in two years and a half, while the increase

[1] Letter from the Deputy Comptroller of the Currency, April 23, 1913.

for the national banks is only four in number and about $9,500,000 in deposits.

It would seem that some of the state bankers now see a little benefit arising from the guaranty scheme. When it was first projected they were bitter over any plan that would tax them to pay the losses of other bankers. There have been no losses, however, and gradually a few extra deposits have come in, — not deposits of large amounts, but here and there $2,000 or $3,000 from people who would not have been expected as depositors, at least as depositors in a state bank without the guaranty. Most of the state bankers have now dropped their active fight on the guaranty plan, and more than a few seem pleased with the way it is working. They are advertising the guaranty on their checks and deposit tickets, and making the most of the system they formerly opposed.

The figures show that the national banks, while not growing so fast as the state banks, have suffered no drain. The national bankers say that the deposits that have left them for the guaranteed state banks have been scarcely perceptible. In a state where no national bank has failed in fifteen years, it would have been surprising to find that state bank guaranty had made national bank depositors uneasy.

The virtual acquiescence of the state bankers is due in part to the fact that no money has been taken out of their banks. The assessments are merely set aside as deposits to the credit of the State Banking Board. The bankers regard this account as a special surplus, and so, in a sense it is; but it is a common surplus, and when it is drawn upon (for Nebraska cannot always escape failures), there will be disappointment and possibilities of trouble. The failure to collect assessments, to get the taxes out of the hands of the taxed

banks, still seems a defect in the Nebraska law, altho the bankers like it.

Another defect is the provision for paying depositors as soon as a bank fails, or as soon as the receiver has calculated how much cash he must draw from the guaranty fund to supplement the cash in the failed bank. The failure of the Oklahoma plan was due to this same provision as much as to any one cause. A series of failures would require immediate large expenditures from the fund, and make emergency assessments necessary. But a series of failures would come, if at all, at a time when all banks were hard up, and when an emergency tax would be a burden and perhaps a danger.

The Nebraska plan is good in that it has accumulated a fund of nearly $1,000,000. It is bad in that it leaves this fund with the very banks that have it to pay, and in that it promises to pay deposits immediately on failure.

It is to be observed, however, that under the administration of the Nebraska banking department the promise to pay depositors immediately on failure seems not to have caused reckless banking. And, as bearing on the existence of a need of deposit guaranty or insurance, the fact that deposits in state banks are guaranteed is found to influence deposits somewhat, even in a state where bank failures have for years been unknown.

IV. Texas

The deposit Guaranty Act of Texas has never been attacked in court. It has been in operation since January 1, 1910, and the results must be called favorable so far. The fiscal year of the Texas banking department ends August 31st. No bank failed at all the first year. One failed the second year, two the third

year and three between August 31, 1912, and the present date (October 9, 1913).

Taking the failures in their order, the Harris County Bank and Trust Company of Houston suspended August 7, 1911, and the examiner uncovered forgeries, false entries, and paper placed in the bank for fraudulent purposes. The president left before he could be apprehended. The guaranty fund was drawn on for $111,649.90 and an emergency assessment for that amount was levied on the guaranteed banks. In 1912, however, a 50 per cent dividend was paid to creditors, and half the assessments returned to the banks.[1]

The Paige State Bank, capitalized at $10,000, was taken over by the banking department early in 1912, because the president had placed $19,000 of worthless paper in the bank. The guaranty fund was called upon for $13,697.90.[2]

The last bank that has cost the fund anything is the First State Bank of Kopperl. It was closed December 6, 1912. Then it was discovered that S. J. Spotts, the president, had been previously convicted of violation of the National Bank Act, and had served a term in a Federal prison. Spotts was found in Los Angeles, was brought back to Texas for trial, and on a plea of guilty was sentenced to four years in the state penitentiary. The deposits of the bank were $16,000 and in paying them $8,000 was used from the guaranty fund.[3]

The three banks that failed subsequently were liquidated without calling upon the fund.[4] The guaranty fund has, therefore, paid only $133,347.80 on account

[1] Report of Commissioner of Insurance and Banking, 1911–12, p. 19.

[2] Ibid., p. 21.

[3] Ibid., p. 19.

[4] Telegram from W. W. Collier, Commissioner.

of failed banks in about four years, and has recovered more than $55,000 of that amount. The showing is considered excellent, and new banks have been organized in large numbers to keep up with the rapid growth of the state. For the fiscal year 1911, 109 state banks and trust companies with capital of $2,522,000 were authorized to begin business. The next year the number was 77 with $3,169,000 capital, but 8 of these were trust companies with $100,000 or more capital each. The 8 had together more than half of the total new capital of the year. The typical new organizations were still banks with the minimum capital permitted, $10,000. In the fiscal year 1912, 23 state institutions with $1,110,000 capital were incorporated.[1]

The Texas banking report for 1913 is not yet at hand, but new organizations must have been numerous, for the number of state banks and trust companies increased from 709 in June, 1912, to 776 in April, 1913. For comparison, the statistics of national bank organizations are here set down. The new banks include conversions of state banks. The data as to the new banks are for the years ending October 31st, and as to the conversions, for calendar years.

	National Banks Organized		State Banks Changed to National Banks	
	Number	Capital	Number	Capital as National Banks
1910	14	$1,875,000	2	$140,000
1911	21	1,255,000	4	215,000
1912	16	2,650,000	6	425,000

Obviously bankers are not afraid to organize under the state system and remain in it, and yet a considerable amount of capital is being invested in national banking. A comparison of bank statements tells much the same

[1] Report of the Commissioner of Insurance and Banking, 1911–12.

story of satisfaction with both systems as administered in Texas, the state system being apparently somewhat preferred.

ITEMS IN ROUND AMOUNTS FROM TEXAS BANK STATEMENTS

State banks[1]	*Nov. 16, 1909*	*April 4, 1913*
Number of banks	502	776
Capital	$ 16,114,000	$ 29,451,000
Surplus	1,475,000	5,806,000
Due to banks	6,541,000	7,664,000
Individual deposits	43,328,000	86,485,000
Due from banks	18,051,000	27,556,000
Cash	5,324,000	9,281,000

National banks	*Nov. 16, 1909*	*April 4, 1913*
Number of books	519	514
Capital	$ 42,393,000	$ 49,625,000
Surplus	19,551,000	25,592,000
Due to Banks	38,744,000	52,209,000
Individual deposits	164,618,000	209,411,000
U. S. Deposits	1,137,000	2,043,000
Due from banks	59,693,000	80,167,000
Cash	22,314,000	26,535,000

It appears that since the enactment of the guaranty law, the state banks have increased fifty per cent in number and their deposits have doubled. There were five more national banks in 1909 than in 1913, but individual deposits in national banks have increased twenty-five per cent and if we could make the comparison after the cotton is marketed this fall, a still larger growth would appear.

Nominally it is optional with Texas banks whether or not they shall have their deposits guaranteed. Any bank may, if its directors prefer, file annually with the Commissioner of Insurance and Banking "a bond, policy of insurance, or other guaranty of indemnity" equal to its capital stock, or, if it is a private bank, "in

[1] Includes Trust Companies.

an amount to be fixed by the Commissioner." This option has not proved attractive, however. A bond or policy procured from a bonding or an insurance company is expensive, and it is embarrassing to ask friends, customers, or even directors, to make the bond. Furthermore, a bond with individual sureties has little effect in attracting or reassuring depositors. In 1909, only 42 banks had elected to furnish bonds. In 1912, the number was only 53.

It has not been found necessary to change the original guaranty law materially. It still provides for an initial assessment of one per cent of deposits, and for subsequent assessments of one-fourth of one per cent per annum, with power to levy emergency assessments, not exceeding two per cent in any year, in case the fund is diminished. Assessments are to cease when the fund reaches $2,000,000, The fund is now, October 9, 1913, $778,824.[1]

The legislature this year, following the example of Kansas and Oklahoma, has provided that the State Banking Board shall refuse charters for new banks where there is not public necessity for them.

Much of the credit for the apparent success of the guaranty system in Texas is accorded to Mr. B. L. Gill, who was Commissioner of Insurance and Banking from January, 1911, to this summer.

Texas, with its rapid economic development and its hundreds of new banks, subject to all sorts of vicissitudes, can scarcely hope always to get off so luckily in failures. The organization of a great many banks during a time of rapid settlement and development has, in other states, been followed almost always by losses to a considerable number of banks and by some bank failures. A good fund is being accumulated in Texas,

[1] Telegram from the Commissioner.

however, and the banking department seems to be efficiently organized and administered. The state banking system is getting into position to withstand some rather heavy shocks, if they come. If they do not come too soon, the Texas guaranty plan will probably survive. This prediction could be made with some confidence if the law were amended to provide for payment of depositors only upon the final liquidation of failed banks; but no such amendment is now being urged.

V. General Arguments and Conclusions

It is now evident that the cause of the Oklahoma bank failures was not deposit guaranty alone, but guaranty plus ineffective examinations, insufficient scrutiny of the previous records of bankers, and unfavorable economic conditions following the period of settlement and rapid growth. This is shown by the fact that in the other states where deposits are guaranteed failures have been few.

The guaranty system has given opportunities to some reckless and criminal bankers in Oklahoma, but it has not turned honest bankers into rogues there, or in the other states we have studied. Deposit guaranty is not stockholders' insurance. Stockholders must lose their whole investment before the guaranty fund suffers any loss, and there is, therefore, not even a financial incentive for a good banker to become a rascal. He may be tempted by guaranteed competition into an unwonted, perhaps unwise liberality, but not to a dangerous extent, if we can judge by the present experience of Kansas, Nebraska, and Texas.

It remains to consider what are the best methods of guaranteeing deposits and whether, in fact, such

guaranty is desirable at all. It is unnecessary here to repeat the arguments stated at some length in the previous article; but one suggestion then advanced should be withdrawn. Deposit insurance by private corporations was mentioned as a possible solution of the problem. But this is now evidently not the solution that is to be used, if the problem is found to be worth solving. While such corporations could select risks and limit their size and distribution, and while there is an example in Kansas of the successful operation of such a company, it is obvious, nevertheless, that if deposits are to be guaranteed or insured on any considerable scale, it will be through the banking departments of the states or conceivably of the United States. The efforts to organize other deposit insurance companies and put them in operation have not met with success. The Kansas example remains solitary.

The stimulus to reckless banking is not the chief danger to the success of deposit guaranty. Kansas, Nebraska, and Texas have so far repressed such tendencies. A greater danger has just been mentioned, the impossibility of limiting the size of single risks or avoiding the concentration of risks in single localities. Whether this danger will prove fatal to the success of the plan, depends largely on the size of the fund accumulated by the time the big losses occur. The Oklahoma fund is insolvent now. Texas is accumulating a $2,000,000 fund, Kansas a $500,000 fund, and Nebraska a fund of one and one-half per cent of deposits, say $1,500,000. Each state should considerably advance the limit now fixed on its fund, and Kansas, at least, should increase its assessment rates. There would then be some probability of establishing reserves large enough to take care of as many failures as can reasonably be expected in these states under present day conditions.

Another danger, social rather than financial, is the real or supposed necessity of accompanying the establishment of the guaranty system with grants of almost despotic power to the state banking departments. The guaranty of deposits is so powerful an inducement to depositors, legislators believe, that for fear of its misuse by the incompetent or unscrupulous the banking departments are empowered not only to regulate and supervise banks, but to say what rates of interest they shall pay, and whether the citizens shall establish more banks. In some states both these powers are exercised. This may be "medieval," but, as in the question whether deposit insurance should be provided by the state or by private corporations, it is sufficient to recognize the irresistible tendency in many forms of industry toward state control. If the state can fix railroad rates, no doubt it can fix rates of interest on deposits. If it can regulate banks, no doubt the power to fix their number and forbid new organizations regarded as superfluous will be upheld. Doubtless the part of wisdom lies in trying to guide this tendency instead of fighting it.

The vital question is whether the public needs greater assurance of the safety of its deposits than can be afforded by the resources of a single bank in a single town. Any reader who may be interested will find the writer's views stated carefully in the article before referred to.[1] Even in states where banking is soundest the bare possibility of failure, and the knowledge of the blight it would bring to business plans and to household life, keeps many people from the banks. They cannot be absolutely sure. They cannot detect the few cases of unsoundness, some or all of which escape bank examiners, business men among the customers, and the

[1] Quarterly Journal of Economics, vol. xxiv, pp. 373 et seq.

directors themselves. There is, therefore, even in the most prosperous days, a good deal of hoarding, and, what is worse, a failure to use the modern labor-saving machinery of exchange. Some additional business comes to guaranteed banks even in states of settled economic and social conditions, like Kansas and Nebraska. The scheme would not have been tried but for the vivid memory of the distress caused by the suspension of cash payments in 1907. Once in force, the plan seems to bring satisfaction to some depositors.

The plan does not spread. Many other state legislatures debated it in the first few years, but less is heard of it now. South Dakota, as we anticipated, has left its plan unused.[1] It would take many failures close together, or a pretty general suspension of payments, to bring about the adoption of the plan now where it is not already in force. If Congress provides an effective method of mobilizing reserves and providing ready credit on farmers' paper, little will be heard of guaranty for some time.

This is not to say that Kansas, Nebraska, and Texas will discontinue the plan. Unless it is causing losses and weaknesses underneath the surface, and the writer cannot find that such is the case, there is not likely to be much agitation for repeal in these three states. In some of them, at least, guaranty funds will be accumulated sufficient to permit of the continuance of the system. Whether the plan will gradually be adopted in other states depends on the force of the present social tendency to distribute more widely, by legislation, the good and evil of life. Workingmen's compensation is analogous. The tendency underlying this legislation and the guaranty legislation seems to the writer exceedingly strong. If this is so, a state here and there will

[1] Ibid., vol. xxiv, p. 360.

from time to time supplement its service of bank regulation and supervision by enabling, if not requiring, the banks to effect insurance in a state-administered fund for the benefit of depositors.

Such insurance is more needed in some localities than in others and should be optional with the banks. If an old bank with large deposits is satisfied to rest on the reputation it has been years in building, it would be wrong to make it pay taxes or premiums to provide for the depositors of other banks. It is safe to say that once such legislation is in force, there will be banks to take the insurance or accept the guaranty. The state for the present will be doing enough for depositors when it enables those who are not sure of the stability of banks to do business with banks whose deposits are insured.

The insurance should not be paid or the guaranty redeemed, until, as in Kansas, the assets are finally liquidated and the bank wound up. To try to pay when the banks close is to attempt the impossible. Economy and social policy alike favor the Kansas plan, for the delay stipulated in payment will keep the depositor from such carelessness in choosing his banker as has been seen in Oklahoma. This is true even if the depositor believes that other bankers would probably cash his guaranty fund certificates in case his own bank failed.

The fund must be large, — not less than two per cent of deposits and larger than that in states where there are several banks with deposits many times the average. Other features desirable in deposit guaranty legislation have been sufficiently discussed in the foregoing pages.

Bank failures have not been the chief defect in American banking. The immobility of reserves and the lack of proper mechanism for the seasonal expansion and

contraction of credits have been far greater. Mobilizing the reserves and providing elastic credits will solve many problems. Our banking system, nevertheless, will remain individual, and our banks numerous and independent beyond anything known abroad. The possibility of failures will be ever in the thought of many, and occasional failures will be inevitable. How to minimize the resulting social and financial loss will remain a problem worthy of the efforts of banker and economist.

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